Pearl Meyer

ADVISOR BLOG

CEO Pay Ratio Watch: The First Filers

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The CEO Pay Ratio watch is on. We are now in the throes of the first proxy season in which U.S. public companies are required to disclose their CEO-to-median employee pay ratios. Pearl Meyer will be tracking all data and trends throughout the season and providing updates via a special "watch" page on our website. As a significant number of proxies with the new disclosure are now publicly available, we have an update on key points so far:

Magnitude of Pay Ratios

Overall, the ratios are lower than forecasted and so far the average is in the 100:1 to 120:1 range, with the median hovering around 75:1. Not surprisingly, early trends seem to be developing that have an impact on median, such as:

- **Industry**: Sectors such as materials, consumer goods, and healthcare have the highest ratios, with companies in the real estate, information technology, and financial fields are running at much lower multiples.
- **Revenue**: The bigger the company, the larger the ratio. The average ratio thus far for companies above $10B in revenues is about 235, while those under $1B is in the 35-37 range.
- **Number of Employees**: Ratios also go up as employee population increases. For those companies with more than 20,000 employees, the average ratio is around 230 compared to about 47 at companies with fewer than 1,500 employees.

Calculation Methodologies

Most of the calculation options and allowed exemptions noted in proxies thus far mimic our experience the past few months helping clients determine and disclose their ratios.

- **Consistently Applied Compensation Measures**: While the SEC provided great flexibility to identify the median employee, certain trends have emerged so far on the most common measures. All companies included base salary and about 60% have included bonus or other annual incentives. Almost a third of the companies include overtime pay. Only around one in five companies have included equity grants, which reflects the fact that stock-based awards are not universally granted at most companies. Most other elements (e.g., commissions, allowances, retirement/pension, and other benefits/perquisites) are only sporadically included. Almost 20% of companies indicated that data was pulled from Form W2.
- **Population Determination Date**: The rules permit companies to survey their population for the median employee at any date in the last three months of the year. About half of the companies chose a date earlier than 12/31/17. In our experience, some clients chose to do this to get a head start on the data, while others decided it was a cleaner approach to wait until the end of the year.
- **Adjustments**:
    - *Annualization*: The rules permit companies to annualize pay for those who were only hired for a partial year, but only 50% of companies so far report using this methodology. In our experience, many companies chose not to do so because it complicated the process and/or it did not influence the ratio in any material respect.
    - *Statistical Sampling*: Similar to our experience with clients, the prevalence of companies disclosing the use of statistical sampling has been low. Only 2% of proxies so far indicate that the company sampled employees rather than surveying the entire population to identify the median employee.
    - *COLA*: So far, not one filer has included ratios using COLA adjustments. We heard clients saying they were averse to using this adjustment because it meant running the methodology two ways, along with disclosing two different ratios which may have detracted from the favorable ratio derived with the COLA adjustment.
- **Exemptions:**
    - *Data Privacy*: As anticipated, not one company as of this date has reported using the data privacy exemption to exclude certain overseas employees. While the SEC permitted the exemption, it required companies to jump through a series of hoops and at the end of the day, companies were able to use workarounds to capture employee data without associations to names to circumvent most privacy laws.

- *De Minimis*: The SEC rules permit companies to exclude from consideration in identifying the median up to 5% of non-U.S. employees. Early disclosure indicates about 25% of companies have taken advantage of this exemption. In our experience, some companies did not avail themselves of this exception because: (1) they had access to non-U.S. data; (2) overseas employees led to a more desirable outcome; (3) they didn't want to include the extra disclosure associated with the exemption (e.g., total number of employees excluded in each jurisdiction); and/or (4) they had an entirely U.S.-based population.
- *Acquisitions*: The rules allow but do not require companies to exclude employees acquired in the past fiscal year and roughly 10% of the companies so far have taken advantage of this exclusion. Based on our experience, many companies did not want to take advantage of this exclusion because: (1) it resulted in increased disclosure, and (2) it would have required the company to re-identify the median employee in the immediate subsequent year, rather than in three years.

Narratives

Thus far, we are seeing companies take a conservative and minimal approach to publicizing their ratio and noting how it was calculated.

- **Supplemental Ratios**: Companies are permitted to provide supplemental ratios based on a methodology that varied from the rules, but only one company has chosen to do so at this juncture by including the value of non-discriminatory benefits in the calculation. Most companies avoided providing non-essential contextual disclosure (i.e., information about the median employee's location and position) this year as well. Next year we may see more of this however, as comparable data (historical and to peers) will be available.
- **Length and Placement of Disclosure**: As anticipated, almost all disclosures have been brief (around three paragraphs) and include only essential data needed to comply with the rule. In addition, most disclosures were not placed within the CD&A itself but rather after the last compensation table.

It remains to be seen how the disclosure of the ratio comparing the CEO's pay to that of the median employee plays out. The wave of anticipated media coverage has commenced and we are beginning to see interviews with labor union leaders and potentially inflammatory headlines. While the public debate heats up and the volume of available proxies picks up, Pearl Meyer's CEO Pay Ratio Watch will keep you up to date on the data.

Source: 2018 Main Data Group

About the Author

Deborah Lifshey is a managing director in the New York office, where she specializes in advising clients on compensation matters from a legal perspective including securities disclosure, taxation and corporate governance issues, negotiation contracts, and reasonableness opinion letters. She is a graduate of the Industrial and Labor Relations School at Cornell University and the University of Florida College of Law, and served as a federal clerk for the Honorable Judge Susan H. Black on the Eleventh Circuit Court of Appeals. Prior to joining Pearl Meyer, Ms. Lifshey practiced at Fried, Frank, Harris, Shriver & Jacobson, where she specialized in executive compensation, ERISA matters, and corporate transactions, and at Holland and Knight, where she specialized in employment litigation matters.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, and Los Angeles.

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